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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Economy Is Weaker Than It Looks

On the surface, at least, it would appear as though the U.S. economy has emerged from the stock market crash of last October in pretty good shape. The top-line gross national product advanced by 2.3 percent at an annual rate in the first quarter, following increases averaging 4½ percent during the previous two quarters. What is more, if one considers only actual sales to final consumers, exclusive of government farm subsidy payments, the first quarter's rise becomes a hefty 4.3 percent, compared with a decline in last year's fourth quarter.

Adding further to the belief that the worst is over are data dealing with employment and personal incomes. Apparently responding more to the size of their order books than to the doings down on Wall Street, businessmen added 331,000 workers per month to their payrolls during the first quarter, compared with an average of 254,000 during the preceding nine months. This pushed up personal incomes by 1.4 percent in the first quarter—not far from the average quarterly rise of 1.6 percent during the previous three quarters. Since consumer spending accounts for about two-thirds of GNP, such increases in employment and incomes would seem to point to further economic strength in the months ahead.

As for the stock market itself, the dark days of last October now seem to be only a bad dream. Encouraged, no doubt, by the market's runup of about 16 percent from its October 19 closing lows, as well as the crash's apparent limited impact on outlays by both consumers and businessmen, economists have come up with a number of reasons to dismiss the crash as a negative factor in the outlook, among them, the fact that the market ran up so fast earlier in 1987 that few had time to enjoy their paper gains; most still have a profit on stocks they've held onto; and relatively few people own stocks directly, anyway.

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Consumers Are Not Big Spenders

However, beneath the veneer of these otherwise shiny statistics lie a few rough spots. For one thing, the consumer isn't as much of a big spender as the first quarter's data make him appear. True, people's purchases of hardgoods jumped by $12 billion, or at an annual rate of nearly 13 percent, in the first quarter from the fourth, after adjusting for inflation. But these outlays are still below levels reached a year and a half earlier. And there was no increase at all in real softgoods expenditures in this year's first quarter—meaning that consumer purchases of hard and softgoods combined remain $15 billion, or more than one percent lower than 18 months ago.

Two other key statistics aren't all that bright, either. People spent less on residential construction last quarter than they did back in second-quarter 1986, in real terms. And since the first quarter's decline was at an annual rate of only nine percent on the heels of a 7½ percent *rise* in the fourth, while housing starts have plunged by an average annual rate of 18 percent during the last two quarters, it seems reasonable to expect that these outlays will post another decline in the current quarter.

Fewer Buildings; More Inventories

Business spending on structures was weak, too. These outlays fell nearly $2 billion in real terms, and are now below levels first reached back in second-quarter 1979! Then there are inventories. Excluding some rather unusual swings in the farm sector, business inventories still appear to be high—at least if the GNP figures are to be believed. Sales would have to remain pretty vigorous for inventory reductions *not* to drag the current quarter's growth.

Even the trade figures are not as good as they look. For one thing, there was only a modest improvement in the trade deficit, as measured in the GNP accounts. To be sure, the inflation-adjusted trade deficit did shrink by $4 billion in the first quarter, compared with a decline of only $2.7 billion in the fourth. However, imports rose, instead of

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falling as most economists had predicted; they have climbed in all but four of the past 20 calendar quarters, leaving the real trade deficit almost as high today as it was at yearend 1985.

Two Bright Spots

One statistic that was undeniably strong was business spending on equipment. In real terms, such outlays went up a whopping $25 billion—the largest quarterly increase on record, and several times the increase expected by most analysts. And, even though a lot of the equipment was not produced in the U.S., but rather, was from overseas, it does not take away from the fact that American business is rapidly becoming more efficient, thus better able to compete both here and abroad.

Another piece of good news can be seen in the inflation rate derived from the GNP accounts. The GNP deflator, or price index, rose at only a 2.4 percent annual rate last quarter, down from the 2.7 percent pace in the previous period—and the fourth quarter in a row in which this index's rate of rise slowed. Of all the measures of economy-wide inflation, this is the most important- and the most accurate—so its slowing should quell

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/20/88)	178,871	+ 1	+ 10,706
New York City (4/27/88)	37,800	– 185	+ 1,845
Commercial Paper (4/27/88)	403,182	+ 5,999	+ 52,513

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/20/88)	297,418	+ 1,445	+ 5,834
New York City (4/27/88)	57,266	+ 282	– 3,852

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/20/88)	880,637	+ 5,528	+29,036
New York City (4/27/88)	175,335	+ 411	–33,902

Financial Markets

	Friday 5/6/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.45%	+ .30	+ .78
180-Day Bills†	6.80	+ .17	+ .71
Longest Bills†	7.28	+ .21	+ .58
Recent Issues:			
75/8S 4/30/90	7.85	+ .17	
77/8S 3/31/92	8.30	+ .14	
81/8S 2/15/98	8.98	+ .36	
87/8S 8/15/17	9.14	+ .05	
Municipals:			
Bond Buyer–20 Bond Index* (5/5/88)	7.84%	+ .07	– .02
Blue List Total ($ Million)	$1,211	– $10	–$ 437
30-Day Visible Supply ($ Million)	$2,127	– $74	–$1,464
Total	$3,338	– $84	–$1,901
Corporates:			
Moody's Aa Composite (5/5/88)	9.97%	+ .07	+ .52
30-Day Visible Supply ($ Million)	$3,090	–0–	–$ 583
Stocks:			
Dow-Jones Averages:			
Industrials	2,007.46	– 24.87	–314.84
Transportation	848.04	+ 6.04	–109.34
Utilities	169.04	– 1.60	– 36.45
65 Stocks	748.76	– 6.18	–120.07
N.Y.S.E. Composite Index	145.88	– 1.99	– 19.61
N.Y.S.E. Avg. Daily Vol. for Week (000's)	145,139	+ 4,103	–36,338

*34% Taxable equivalent 11.88%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/6/88	Week Ago
Overnight	6.69%	6.88%
1 month	7.00	7.00
3 month	7.25	7.19
6 month	7.56	7.44
1 year	7.94	7.88
EURODOLLAR BONDS Average Yield		
Medium Term (5 yrs.)	9.18%	9.18%
Long Term (10 yrs.)	10.12	10.12

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/6/88)	Currency Per U.S. $	Week Ago
Canada	1.2342	1.2286
France	5.7200	5.6725
Germany	1.6823	1.6687
Italy	1254.00	1242.70
Japan	124.89	124.65
Mexico	2273.00	2273.00
Switzerland	1.4028	1.3980
U.K.*	1.8630	1.8870

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (5/6/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.8%	–5.5%

the fears of incipient inflation that have arisen in the bond markets of late.

True, there is some inflation building up in the pipeline. Prices of industrial raw materials—the beginning of the production process—shot up more than 40 percent from the end of August 1986, to the beginning of last October, although they have stabilized since. And at the next stage, the producer, or wholesale level, prices of intermediate materials excluding food and energy have risen quarter by quarter at a progressively faster rate since mid-1986. Even the top-line producer and consumer price indexes showed large increases in March.

Keep in mind, however, that these indexes are based on weights that do not change from one period to the next, whereas the GNP deflator's do. Its weights are based on current consumption patterns—not those of some earlier period. This means that, while prices of some goods may be rising faster than before, people are shunning these goods, in favor of those whose price changes are more moderate. So the actual cost of goods purchased is going up much more slowly than the reading suggested by the various fixed-weight price indexes. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/4/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	237.184	+ 8.065	+ 5.621
Loans to Depository Inst.	2.414	+ .380	+ .393
Float	.686	+ .111	+ .374
Total Reserve Bank Credit	256.245	+ 8.871	+ 5.038
Treasury Deposits with Federal Reserve Banks	14.094	+ 9.711	− 8.750
Currency in Circulation	228.667	+ .636	+18.212
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	228.833	+ 2.177	+51.444
	5/4/88		
Member Bank Reserves:			
Total Reserves Held	59.688	− .988	+ 1.555
Excess (Deficiency)	1.215	+ .531	+ .199
Net Free Reserves	.778	+ .435	+ .873
Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (4/25/88)	778.0	+ 6.1	+ 3.3
M2 (4/25/88)	2,996.0	+ 9.5	+ 5.0
M3 (4/25/88)	3,763.5	+ 8.5	+ 6.0
Domestic Nonfinancial Debt (4th Q'87)	8,361.5	+ 10.2	+ 10.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 5/6/88	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.25%	6.45%	6.82%
* Federal Agencies	6.75	6.85	7.00
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.20	7.42	7.23
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.12	7.40	7.80

‡Finance Company Paper—Prime

5- 14 days	6.70%
15- 29 days	6.83
30- 59 days	6.88
60- 89 days	6.90
90-179 days	6.88
180-239 days	6.88
240-270 days	6.88

‡* Bankers' Acceptances

Jun.	6.88%
Jul.	6.90
Aug.	6.95
Sep.	7.03
Oct.	7.12
Nov.	7.10

‡Industrial Paper—Prime

30- 89 days	6.89%
90-120 days	6.95

†Federal Funds Effective Rate 6.90%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'88n	$ 4,661	$ 4,607	$ 4,378
Gross National Product (1982 Dollars)*	1st Q'88n	$ 3,903	$ 3,881	$ 3,772
Percent Change, Annual Rate	1st Q'88n	2.3	4.8	4.4
Change in Consumer Prices*	Mar '88	6.0%	2.4%	4.8%
Change in Producer Prices*	Mar '88	7.2%	− 2.4%	4.8%
Civilian Employment (Thousands of Persons)†	Apr '88n	114,713	114,103	111,806
Unemployment as % of Civilian Labor Force†	Apr '88n	5.4%	5.6%	6.3%
Personal Income*	Mar '88n	$ 3,924	$ 3,895r	$ 3,683
Leading Indicators Composite Index (1967=100)†	Mar '88n	193.3	191.7r	187.6
Industrial Production Index (1977=100) †	Mar '88	134.6	134.4	127.4
Net Change in Consumer Installment Credit †	Mar '88n	$ 4.46	$ 5.04r	$ 1.84
U.S. Merchandise Trade Balance	Feb '88	−$ 13.83	−$ 12.44	−$ 14.36
Plant and Equipment Expenditures*	2nd Q'88	$427.09(a)	$422.75(a)	$377.65
Private Housing Starts (Thousands of Units)*	Mar '88	1,543	1,514	1,723
New Construction Expenditures*	Mar '88n	$ 401.8	$ 396.0r	$ 388.3
Total Business Inventories †	Feb '88	$ 715.9	$ 715.0	$ 665.7
Total Business Sales †	Feb '88	$ 468.3	$ 465.7	$ 442.4

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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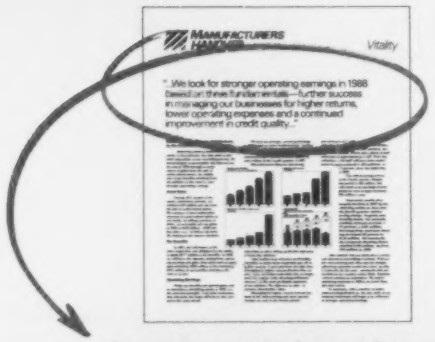
Results


MANUFACTURERS HANOVER
Vitality
"...We look for stronger operating earnings in 1988 based on three fundamentals—further success in managing our businesses for higher returns, lower operating expenses and a continued improvement in credit quality."

Projections, 1987 Annual Report:

"...stronger operating earnings, restoring shareholders' equity."

Update, Annual Meeting, April 1988:

"For the first quarter...$140.3 million net income. $700 million in new equity."

Excerpts from remarks by Chairman John F. McGillicuddy at the MHC annual meeting on April 22, 1988.

"We looked for stronger operating earnings in 1988 based on three fundamentals—further success in managing our businesses for higher returns, lower operating expenses and a continued improvement in credit quality.

"For the first quarter, net income totalled $140.3 million—an increase of 73.2 percent over last year's first quarter and representing our highest ever quarterly net income.

"And these record results are characterized by a very strong operating earnings component.

"Also during the first quarter, we continued to demonstrate success in cost control, an area that will continue to be a priority item for us.

"In summary, then, Manufacturers Hanover's operating results in the first quarter were ahead of what we had been projecting.

"And our *overall* results—including tax benefits and other special gains—are also ahead of schedule in terms of the total financial plan we had laid out. The sale of our consumer finance subsidiary is a major part of that plan.

"This will result in a pre-tax gain of $300 million—and, after recognition of tax benefits, will add approximately $275 million to common shareholders' equity.

"Thus, on a pro forma basis, if you include the effect of this transaction, our common equity on March 31st would equate to $2.43 billion, or 3.45 percent of assets. This is up $700 million from June 30th of last year, when our ratio was 2.36 percent.

"We already had a higher equity-to-asset ratio at the Trust Company. On an actual basis at March 31st, it stood at 3.34 percent of assets, and we will continue to build on this base.

"Following the sale of our consumer finance subsidiary, we will make another capital infusion in the Trust Company, bringing its ratio of common shareholders' equity to assets to approximately 4.0 percent. **By year's end, our plan is to achieve a ratio of 4.5 percent.**

"The capital restoration plan we presented in our annual report and its most fundamental component, strong earnings from our core businesses, are running ahead of plan.

"Thanks to the extraordinary effort of the men and women of Manufacturers Hanover, 1988 looks even more promising than the picture we portrayed to you in our annual report."

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